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International  
Accounting Standards  
Board

*This observer note is provided as a convenience to observers at IFRIC meetings, to assist them in following the IFRIC's discussion. Views expressed in this document are identified by the staff as a basis for the discussion at the IFRIC meeting. This document does not represent an official position of the IFRIC. Decisions of the IFRIC are determined only after extensive deliberation and due process. IFRIC positions are set out in Interpretations.*

*Note: The observer note is based on the staff paper prepared for the IFRIC. Paragraph numbers correspond to paragraph numbers used in the IFRIC paper. However, because the observer note is less detailed, some paragraph numbers are not used.*

## INFORMATION FOR OBSERVERS

**IFRIC meeting:** September 2006, London

**Project:** Presentation of “net finance costs” on the face of the income statement (Agenda Paper 8(ii))

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## SUMMARY OF THE ISSUE

1. The October-2004 IFRIC Update published the following IFRIC decision on presentation of ‘net finance costs’:

The IFRIC discussed a potential agenda topic of whether it is acceptable to present a line item ‘net finance costs’ (or a similar term) on the face of the income statement without showing the finance costs and finance revenue composing it.

IFRIC members had an open discussion of the issue. They noted that paragraph 81 of IAS 1 requires the face of the income statement to include line items that present, inter alia, amounts for revenue and finance costs. IFRIC members agreed that:

- **taken together, paragraphs 32 and 81 of IAS 1 preclude presenting ‘net finance costs’ (or a similar term) on the face of the income statement** without showing the finance costs and finance revenue composing it; but

- this does not preclude presentation of finance revenue followed immediately by finance costs and a subtotal (e.g. ‘net finance costs’) on the face of the income statement.

The IFRIC agreed not to develop an Interpretation on this issue.

2. IFRS 7 *Financial Instruments: Disclosures*, which was issued in 2005, is effective for annual periods beginning on or after 1 January 2007. IG 13 of IFRS 7 states that:

**The total interest income and total interest expense disclosed in accordance with paragraph 20(b)<sup>1</sup> is a component of the finance costs**, which paragraph 81(b) of IAS 1 requires to be presented separately on the face of the income statement. The line item for finance costs may also include amounts that arise on non-financial assets or non-financial liabilities.

3. IG 13 of IFRS 7 can be read as requiring interest income and interest expense to be presented net on the face of the income statement because IG 13 of IFRS 7 states that they are components of finance costs.
4. The issue is whether IFRSs (including IFRS 7) allow entities to present interest income and interest expense net (‘net finance cost’) on the face of the income statement, without presenting gross interest income and interest expense on the face of the income statement. That is, whether the IFRIC’s October 2004 analysis is still valid in the light of IG 13 of IFRS 7.

## **STAFF ANALYSIS AND RECOMMENDATION**

5. IFRS 7 is a disclosure standard, the objective of which is to require entities to provide disclosures in their financial statements that enable users to evaluate (i) the significance of financial instruments for the entity’s financial position and performance; and (ii) the nature and extent of risks arising from financial instruments to which the entity is exposed during the period and at the reporting date, and how the entity manages those risks (see IFRS 7.1).

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<sup>1</sup> IFRS 7.20(b) states that an entity shall disclose the total interest income and interest expense (calculated using the effective interest method) for financial assets or financial liabilities that are not at fair value through profit or loss.

6. IFRS 7.20(b) requires an entity to disclose total interest income and total interest expense (calculated using the effective interest method) for financial assets or financial liabilities that are not at fair value through profit or loss either on the face of the financial statements or in the notes<sup>2</sup>. It does not set out requirements for whether interest income and interest expense should be offset.
7. By contrast, the question raised with the IFRIC, in the staff's view, is a presentation issue that relates to whether interest income and interest expense can be offset on the face of the income statement.
8. IAS 32 *Financial Instruments: Presentation* does not address offsetting of interest income and interest expense. It is necessary to refer to IAS 1 *Presentation of Financial Statements* that sets out the requirements on whether income and expenses can be offset or not. IAS 1.32 states that income and expenses should not be offset unless required or permitted by a Standard or an Interpretation. IAS 1.33 notes that offsetting is not allowed unless it reflects the substance of the transaction or other event.
9. IAS 18 indicates that interest income is one of the significant categories of revenue, which should be disclosed in the financial statements in accordance with IAS 18.35(b). Moreover, IAS 1.81 requires that, as a minimum, the face of the income statement should present (i) revenue and (ii) finance costs.
10. For the above reasons, the staff believes that interest income and interest expense should not be presented net on the face of the income statement (unless, as previously decided by the IFRIC, the gross amounts of interest income and interest expenses are also shown on the face of the income statement).
11. The staff acknowledges that IG 13 of IFRS 7 is confusing. Indeed, the staff believes that interest income is not always a component of 'finance costs' for presentation purposes. For entities engaging in money-lending businesses, interest income may be classified as revenue. The staff has considered the financial statements of some financial institutions which early adopted IFRS 7. All of them present gross interest income and interest expenses separately on the face of the income statement.

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<sup>2</sup> Same disclosure requirement as in paragraph 94(h)(i) of IAS 32 *Financial Instruments: Disclosure and Presentation*.

12. Furthermore, the staff believes that entities should refer to IAS 1 for presentation requirements (e.g. offsetting requirements) and IFRS 7 for disclosure requirements. However, in order to avoid confusion, the staff believes that IG 13 of IFRS 7 should be altered. At its meeting in July 2006, the Board approved a procedure on making non-urgent and minor amendments to IFRSs on an annual basis ('Annual Improvement Process'). The staff has prepared two possible amendments for the Board to consider (see Appendix 1 to this agenda paper). At present, the staff does not recommend which amendment is more appropriate.
13. Since the requirements in IAS 1.32 and 1.81 are clear, the staff recommends that the issue should not be taken onto the agenda.
14. [Paragraph omitted from observer note.]
15. [Paragraph omitted from observer note.]

**Appendix 1: Possible amendments to IG 13 of IFRS 7 [Omitted from observer note.]**